HARVARD LAW REVIEW

Published monthly, during the Academic Year, by Harvard Law Students

SUBSCRIPTION PRICE, $4.50 PER ANNUM . . . . . 60 CENTS PER NUMBER

KNOWLEDGE OF A DIRECTOR AS KNOWLEDGE OF A CORPORATION.[1] — A meeting of the board of directors of a banking corporation has been called. Seven directors are present. The discount of a promissory note of a partnership with which the bank has had many similar transactions is before the board. The note has been signed by one of the partners on behalf of the firm as has been customary. But the fact that the partnership was dissolved prior to the affixing of this signature is known only to two of the directors, who make no mention of it in the meeting. These two directors, with intent to serve their own interests and in disregard of their duty to the corporation, vote in favor of the discount and two of the other directors vote likewise. The other three vote against discounting the note, but the discount is made. The bank now sues the other partners upon the note. Will it be charged with knowledge of the dissolution so as to bar its recovery?

In the above hypothetical case it will be noted that the directors having the knowledge of the dissolution (1) are engaged in corporate business at a board meeting, (2) do not comprise a majority of the directors present, but (3) their votes are essential to produce the corporate action of discounting the note.

There are various situations in which the knowledge of a director becomes a material issue, but which are distinct from the present prob-

[1] For a discussion of this subject, which has received scant attention in legal periodicals, see U. M. Rose, "Notice to Directors — How Far Binding on a Corporation," 6 SOUTH. L. REV. 45; Edwin G. Merriam, "Notice to Corporations," 6 SOUTH. L. REV. 793.

lem. Suppose a director is acting, not as a member of the board, but as an agent of his corporation. What effect has his knowledge upon the corporation? The law is settled that a corporation is responsible to the same extent as a natural principal for the acts of its agents, including improper acts, done in the scope of the agency.[2] An agent's knowledge of facts concerning any transaction done in the scope of the agency should be treated as his acts are treated, and a principal, corporate or natural, should therefore be bound by it.[3] But courts have developed an exception to such a general rule where an interest of the agent "adverse" to his principal is shown and have refused to impute knowledge in such cases.[4] When the effect of an agent's acts are in controversy as between the principal and third persons the fact that the agent has acted improperly or adversely towards his principal does not protect the principal, provided the act was within the scope of the agency.[5] Why should a different rule prevail when the effect of an agent's knowledge is in dispute? The misleading nature of the word "adverse" may be the answer. In the majority of cases where the agent is said to be acting "adversely," it will be found that he is acting for himself, and not for his principal, so that the act done cannot be considered as done within the scope of the agency.[6] Whether an act is within the scope of the agency depends not solely on the nature of the act, but also on the intent with which the act is done.[7] Thus, in *Allen* v. *The South Boston R. R. Co.*,[8] the plaintiff employed a stockbroker to purchase stock of the defendant corporation. The broker was treasurer of the corporation and had been intrusted with blank certificates of stock which he fraudulently and for his sole benefit sold to the plaintiff after all the capital stock had been issued. The defendant sought to have the knowledge of the broker imputed to the plaintiff but the court refused to do so on the ground that the acts of the broker were beyond the limits of his agency with the plaintiff. It is submitted that this is the correct test, whether the principal is a human being or a corporation, and that this is the only significance to be attached to the adverse interest of an agent.[9]

But when a director, who has not been delegated an agent with respect to the matter in question, is present at the meeting of the board when action is taken upon the matter, and does not communicate to the board the pertinent information which he has, will the corporation be charged with his knowledge? It is clear that the mere participation of one such director in the corporate action is cause for imputing his knowledge to

---

[2] The N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30 (1865). See Ranger *v.* Great Western Ry. Co., 5 H. L. Cas. 71, 86 (1854).

[3] See 2 MECHEM, AGENCY, 2 ed., § 1822; WHARTON, AGENCY, § 184.

[4] American Surety Co. *v.* Pauly, 170 U. S. 133 (1898). See 4 FLETCHER, CYC. CORP., § 2243; 2 MECHEM, AGENCY, 2 ed., § 1815.

[5] North River Bank *v.* Aymar, 3 Hill (N. Y.), 262 (1842); Limpus *v.* London General Omnibus Co., 1 H. & C. 526 (1862); Howe *v.* Newmarch, 12 Allen (Mass.), 49 (1866). See HUFFCUT, AGENCY, 2 ed., §§ 153, 157.

[6] Platt *v.* Birmingham Axle Co., 41 Conn. 255 (1874); Frenkel *v.* Hudson, 82 Ala. 158, 2 So. 758 (1887); Indian Head Nat. Bank *v.* Clark, 166 Mass. 27, 43 N. E. 912 (1896); American Surety Co. *v.* Pauly, *supra*.

[7] Illinois Central R. R. Co. *v.* Latham, 72 Miss. 32, 16 So. 757 (1894).

[8] 150 Mass. 200, 22 N. E. 917 (1889).

[9] See 2 MECHEM, AGENCY, 2 ed., § 1822.

the corporation provided such director did not withhold the information to serve a purpose of his own.[10] It is his duty to disclose to the board all facts pertinent to the matter before it,[11] and the corporation should have a remedy against him for violation of that duty. It will promote more intelligent corporate action if each director realizes that his failure to impart pertinent information will be a ground for charging the corporation. Such a rule does not make the conduct of corporate business too risky, for a director will rarely [12] fail to impart pertinent information unless he has a purpose of his own to be served.

Some courts have held that the corporation is likewise to be charged with the knowledge of a single director, acting in a board meeting, even when he has withheld his information to serve a purpose of his own.[13] Although an agent's adverse interest may remove his acts beyond the scope of the agency, it would seem that a director is acting as a director, whatever his motives, when he votes at a board meeting. But, it is submitted, this rule is too severe when the single director was not essential to produce the directorate action.[14] For it charges the corporation with knowledge of a nonessential minority in cases where we may be sure the pertinent information will not be revealed to the rest of the board.

But if the corporation is seeking to assert some right or title which it would not have obtained without the action of its directors, then the corporation ought to be charged with the knowledge of any single director, whose vote was essential to the directorate action, even if the director so voted, with intent to serve his own interests and in disregard of the interests of the corporation.[15] And this should be the law, even if there is no precise analogy from the law of agency; for the relation of a corporation to those human beings in whom are vested the powers of management is a closer relation than that between one human being who is a principal and another human being who is an agent. It would follow that, in the hypothetical case put at the opening of the note, the corporation should be charged with knowledge of the dissolution of the partnership, because the vote of the two directors who acted improperly was essential to bring about the discount. *A fortiori*, the corporation

[10] Nat. Security Bank *v.* Cushman, 121 Mass. 490 (1877). See 4 FLETCHER, CYC. CORP., § 2232. *Cf.* STORY, AGENCY, 9 ed., § 140, b.

[11] Union Bank *v.* Campbell, 4 Humph. (Tenn.) 394 (1843). See Edwin G. Merriam, "Notice to Corporations," 6 SOUTH. L. REV. 793, 811.

[12] The scarcity of cases involving such a situation is not surprising and seems convincing.

[13] Bank of United States *v.* Davis, 2 Hill (N. Y.), 451 (1842). See 1 MORSE, BANKS AND BANKING, 3 ed., § 134. *Contra*, La. State Bank *v.* Senecal, 13 La. 525 (1839); Terrell *v.* The Branch Bank at Mobile, 12 Ala. 502 (1847); Custer *v.* Tompkins County Bank, 9 Pa. St. 27 (1848). *Cf.* Shattuck *v.* Guardian Trust Co., 145 App. Div. 734, 130 N. Y. S. 658 (1911).

[14] Though many courts recognize this and do not impute a director's knowledge to the corporation, the reason given is that he was acting "adversely" and hence that knowledge of the corporation will not be presumed. Innerarity *v.* Merchants' Nat. Bank, 139 Mass. 332, 1 N. E. 282 (1885); Home Building & Loan Ass'n *v.* Barrett, 160 Mo. App. 164, 141 S. W. 723 (1911). This overlooks the fact that all corporate action must, in the nature of things, be vicarious and that the problem is to determine when it is proper to hold a corporation for the acts, omissions, or knowledge of human beings.

[15] Mercier *v.* Canonge, 8 La. Ann. 37 (1853). See 1 MORSE, BANKS AND BANKING, 3 ed., § 112 (6).

would be charged with knowledge possessed by the majority of the directors, even if they did not disclose it to the minority, and acted with intent to serve their own interests and in disregard of the interests of the corporation.[16] The converse situation is illustrated by the recent case of *Western Securities Co.* v. *Silver King Consolidated Mining Co.*,[17] where the votes of the two directors who were acting to serve their own fraudulent scheme comprised only a minority and were not essential to produce the directorate action. Their knowledge was properly held not to be imputed to the corporation.

TRIAL OF CIVILIANS BY MILITARY COURTS IN TIME OF PEACE. — A federal court was recently faced with the problem of the jurisdiction of a military court over civilians. The governor of Texas had suspended the local officials, declared a state of martial law, and directed the militia to maintain law and order. The defendant was fined and, upon his refusal to pay, imprisoned by a military court for exceeding the speed limits fixed by ordinance. His petition for a writ of *habeas corpus* was denied by the federal court and the jurisdiction of the military court upheld as a proper exercise of martial law.[1]

Martial law in its correct sense is simply the will of the military commander of a territory exercised in accordance with the usages of war.[2] It corresponds in a way to what in France and other continental countries is called a state of siege.[3] Where it exists the functions of the civil tribunals are or may be suspended and for the time vested in the military arm of the state. And just as the régime of the civil law is both preventive and punitive so also is that of martial law.[4] Our problem is to determine whether there is a place in our constitutional system for martial law in this sense apart from actual war.

Martial law must be sharply distinguished from the common-law power of a sovereign, — sometimes called qualified martial law,[5] — to employ all force necessary to meet opposition to the law of the land.[6] By virtue of that power the state may in time of disturbance call upon the militia to help maintain the orderly administration of the law by dispersing mobs, quelling riots, safeguarding life and property, and arresting and detaining persons obnoxious to the safety of the community.[7] Indeed the proper authorities must, when the occasion arises, so

---

[16] See Lyne *v.* Bank of Kentucky, 5 J. J. Marsh. (Ky.) 545, 559 (1831).

[17] 192 Pac. 664 (Utah). See RECENT CASES, p. 674, *infra*.

[1] United States *ex rel.* McMaster *v.* Wolters, 268 Fed. 69 (1920). For a statement of the facts in this case see RECENT CASES, p. 673, *infra*.

[2] See GLENN, THE ARMY AND THE LAW, 157, 158.

[3] See DICEY, LAW OF THE CONSTITUTION, 8 ed., 287.

[4] See GLENN, *supra*, 166.

[5] See Commonwealth *v.* Shortall, 206 Pa. 165, 55 Atl. 952 (1903).

[6] See DICEY, *supra*, 284; see Holdsworth, "Martial Law Historically Considered," 18 L. Q. REV. 117, 128. See BIRKHIMER, MILITARY GOVERNMENT AND MARTIAL LAW, 433.

[7] Luther *v.* Borden, 7 How. (U. S.) 1 (1849); Druecker *v.* Salomon, 21 Wis. 621 (1867); *In re* Boyle, 6 Ida. 609, 57 Pac. 706 (1889); Commonwealth *v.* Shortall, *supra; In re* Moyer, 35 Colo. 159, 85 Pac. 190 (1905); Moyer *v.* Peabody, 212 U. S. 78 (1909);